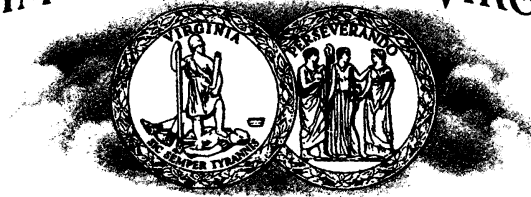


**EXAMINATION REPORT**  
**of**  
**SOUTHERN HEALTH SERVICES, INC.**  
**Richmond, Virginia**  
**as of**  
**December 31, 2007**

# COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS  
COMMISSIONER OF INSURANCE  
STATE CORPORATION COMMISSION  
BUREAU OF INSURANCE



P.O. BOX 1157  
RICHMOND, VIRGINIA 23218  
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<http://www.state.va.us/scc>

I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Southern Health Services, Inc. as of December 31, 2007, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand  
and affixed to the original the seal of the Bureau at the City  
of Richmond, Virginia this 25<sup>th</sup> day of November, 2008

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Alfred W. Gross  
Commissioner of Insurance

(SEAL)

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Richmond, Virginia  
August 29, 2008

Honorable Alfred W. Gross  
Commissioner of Insurance  
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by the authority of Section 38.2-4315 of the Code of Virginia, an examination of the records and affairs of

**SOUTHERN HEALTH SERVICES, INC.**

Richmond, Virginia

hereinafter referred to as the Corporation, has been completed. The report thereon is submitted for your consideration.

**DESCRIPTION**

The Corporation became licensed in Virginia as a health maintenance organization ("HMO") pursuant to Chapter 43 of Title 38.2 of the Code of Virginia on April 1, 1991. The Corporation was last examined by representatives from the State Corporation Commission's (the "Commission") Bureau of Insurance (the "Bureau") as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2007.

**HISTORY**

Southern Health Services, L.P. (the "Partnership") was organized on November 21, 1983 and became licensed as an HMO on March 15, 1985. The Partnership's general partner was Southern Health Management Corporation (the "General Partner"), a Subchapter S corporation formed on November 23, 1983.

Effective April 1, 1991, the Partnership and the General Partner were reorganized and merged into Southern Health Management Corporation ("SHMC"). Southern Health Services, Inc. (the "Corporation") succeeded the Partnership when the Partnership transferred its assets and liabilities to SHMC and SHMC simultaneously transferred certain assets and liabilities to the Corporation. The Corporation became a federally qualified HMO on June 1, 1991.

On September 14, 1994, SHMC, Coventry Corporation and Coventry Acquisition Sub, Inc., a wholly owned subsidiary of Coventry Corporation, entered into an Agreement and Plan of Reorganization. In accordance with terms of the Agreement, Coventry Acquisition Sub, Inc. would merge with and into SHMC, with SHMC becoming the surviving entity. The merger was approved by the Bureau on November 8, 1994. On December 1, 1994, the Plan of Merger was closed and the Certificate of Merger was filed with the Commonwealth of Virginia. At the time of the merger, Coventry Corporation became the sole shareholder of SHMC by converting the outstanding shares of SHMC's common stock into approximately \$75,000,000 worth of Coventry Corporation's common stock. During 1996, SHMC changed its name to Coventry HealthCare Management Corporation ("CHMC").

On January 27, 1998, the Bureau approved a change in control of the Corporation. Principal Health Care, Inc. merged with Coventry Corporation, forming a new company, Coventry Health Care, Inc. ("Coventry"). CHMC continued to be the immediate parent company of the Corporation and Coventry became the immediate parent company of CHMC.

On July 27, 2001, Coventry entered into a Stock Acquisition Agreement with the Rector and Visitors of the University of Virginia ("UVA"), the University of Virginia Health Services Foundation and Blue Ridge Health Alliance, Inc. ("BRHA") to purchase 100% of the issued and outstanding capital stock of BRHA, including its wholly owned subsidiary, QualChoice of Virginia Health Plan, Inc. ("QualChoice"), a Virginia domiciled HMO that was initially licensed in Virginia on January 4, 1995. Upon acquisition of BRHA's capital stock, BRHA, QualChoice and the Corporation merged, with the Corporation remaining as the surviving entity. The Bureau approved the transaction on August 28, 2001 and the acquisition and merger was completed on September 1, 2001.

Effective September 30, 2002, the Corporation merged with and into CHMC with the Corporation remaining as the surviving entity. Prior to the merger the Corporation was a wholly owned subsidiary of CHMC and, as a result of the merger, all outstanding shares of the Corporation were transferred to Coventry.

### **CAPITAL AND SURPLUS**

At December 31, 2007, the Corporation's capital and surplus was \$57,224,843. According to the amended and restated Articles of Incorporation, the Corporation has the authority to issue 1,000 shares of common capital stock with a par value of \$.01 per share. As of December 31, 2007, 1,000 shares were issued and outstanding, with gross paid in and contributed surplus of \$106,211,202 and unassigned funds of (\$48,986,369).

### **NET WORTH REQUIREMENT**

Section 38.2-4302 of the Code of Virginia states that an HMO licensed in Virginia shall maintain a minimum net worth in an amount at least equal to the sum of uncovered expenses, but not less than \$600,000, up to a maximum of \$4,000,000. 14 VAC 5-210-60 A requires that an HMO report the sum of its uncovered expenses for each three-month period ending December 31, March 31, June 30 or September 30. Because the sum of the Corporation's uncovered expenses for the three-month period ending December 31, 2007 was \$13,088,461, the Corporation's minimum net worth requirement at December 31, 2007 was \$4,000,000.

### **MANAGEMENT AND CONTROL**

The bylaws of the Corporation provide that the business and affairs of the Corporation shall be managed by the Board of Directors (the "Board"). The minimum number of Directors shall be three with the actual number fixed by the affirmative vote of a majority of the entire Board. Each director shall be elected for one year or until the next annual meeting of the Corporation's shareholders. A majority of the directors elected to hold office shall constitute a quorum for the transaction of business.

The officers of the Corporation shall consist of a President, a Treasurer and a Secretary. Additional officers, including a Chairman of the Board and assistant officers, may be elected or appointed by the Board. Any two or more offices may be held by the same person. At December 31, 2007, the Board and Officers were as follows:

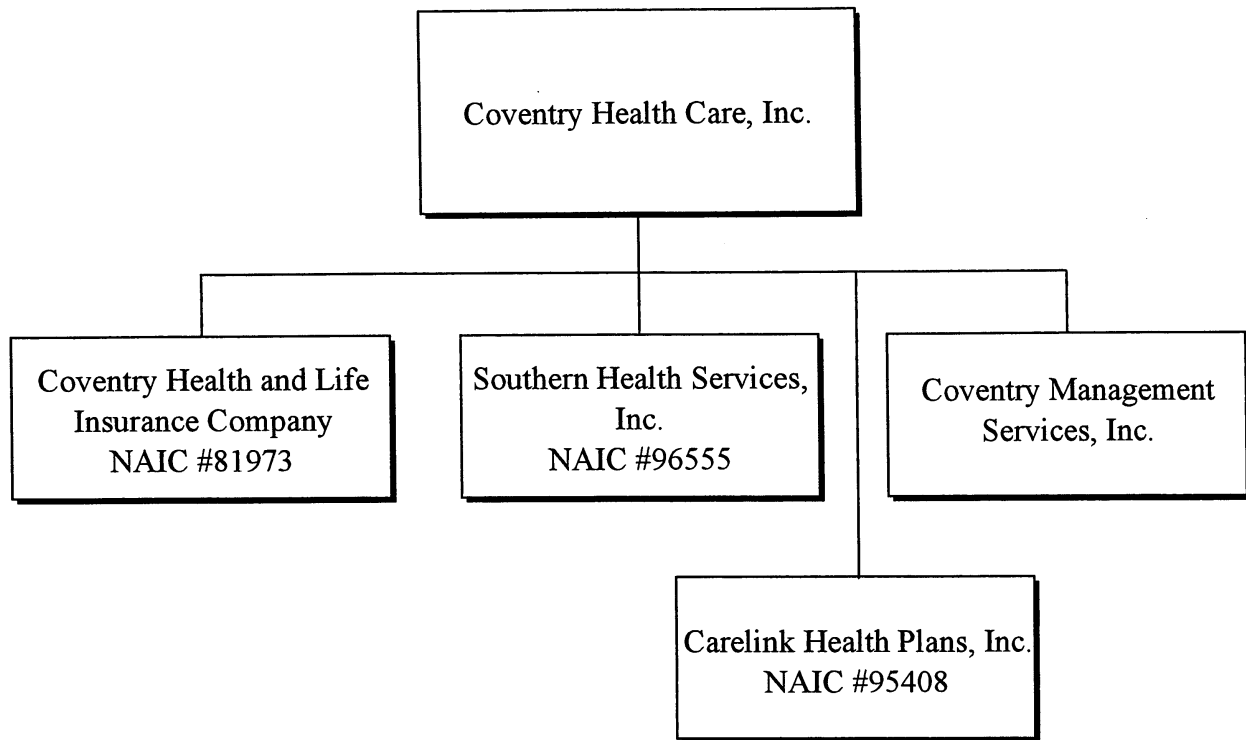
<u>Directors</u>	<u>Principal Occupation</u>
Cosby M. Davis, III	President and Chief Executive Officer Southern Health Services, Inc. Richmond, Virginia
Emerson D. Farley, Jr., M.D.	Retired Physician Fork Union, Virginia
Shawn M. Guertin	Chief Financial Officer Coventry Health Care, Inc. Bethesda, Maryland
Thomas P. McDonough	Chief Operating Officer Coventry Health Care, Inc. Bethesda, Maryland
Hassan S. Rifaat	Sector Senior Vice President Coventry Health Care, Inc. Atlanta, Georgia

### Officers

Cosby M. Davis, III	President and Chief Executive Officer
Francis S. Soistman	Executive Vice President
Thomas P. McDonough	Executive Vice President
Drew A. Joyce	Vice President and Chief Financial Officer
Matthew J. Meleski	Vice President, Provider Contracting
John J. Stelben	Treasurer
G. Kenneth Robinson, III	Assistant Treasurer
John J. Ruhlman	Corporate Controller
Denise W. Bartlett	Assistant Corporate Controller
Debra Pennington	Secretary
Shirley R. Smith	Assistant Secretary
Jonathan D. Weinberg	Assistant Secretary

### AFFILIATED COMPANIES

The Corporation is a wholly owned subsidiary of Coventry. The following chart shows the organizational structure of Coventry and selected subsidiaries at December 31, 2007:





## **TRANSACTIONS WITH AFFILIATES**

### **Management Services Agreements**

Effective January 1, 2003, the Corporation entered into a Management Services Agreement with Coventry. Under the terms of the agreement, Coventry shall perform certain administrative services including, but not limited to, senior management, advertising, actuarial services, marketing and public relations, purchasing, pharmacy services, corporate and legal services, regulatory compliance and governmental affairs, accounting services, tax compliance and consulting, facilities management, risk management, human resources consulting and payroll services. As compensation, the Corporation pays Coventry \$3.15 per member per month. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation incurred \$6,074,829 in fees related to the agreement in 2007.

Effective January 1, 2003, the Corporation entered into a Management Services Agreement with Coventry Management Services, Inc. ("CMS"). Under the terms of the agreement, CMS shall perform the following services:

- a. Information System Services. Provide all services relating to information system equipment and services, including, but not limited to, desktop support, application development, data center support, telecommunications support and network support.
- b. Service Center Services. Provide claims processing services, data integrity services, fraud and recovery support, premium billing and collection services, enrollment and eligibility services, member services and benefit and contract administration.

As compensation, the Corporation pays CMS \$4.32 and \$3.33 per member per month for information system services and service center services, respectively. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation incurred \$6,421,962 in information system fees and \$8,331,193 in service center fees related to the agreement in 2007.

### Administrative Services Agreement

Effective January 1, 2002, the Corporation entered into an Administrative Services Agreement with Coventry Health and Life Insurance Company ("CHLIC"). Pursuant to the agreement, the Corporation shall perform certain administrative services for CHLIC including management and general administrative services, sales and marketing, financial services, medical management, provider relations and contracting, and facilities and support. For these services, the Corporation is reimbursed \$14 per CHLIC member per month. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation charged \$4,316,802 in fees related to this agreement during 2007.

### Management Services Agreement

Effective April 1, 2006, the Corporation entered into a Management Services Agreement with Carelink Health Plans, Inc. ("Carelink"). Pursuant to the agreement, the Corporation shall provide senior management services, medical management services, regulatory compliance and governmental affairs, financial and accounting services and human resources consulting. For these services, the Corporation is reimbursed \$4 per Carelink member per month. The agreement automatically renews on January 1 of each year for successive one-year terms unless terminated by either party upon 90 days written notice prior to the end of any term. The Corporation charged \$3,454,820 in fees related to this agreement during 2007.

### Excess Risk Insurance Agreement

Effective April 1, 2007, the Corporation entered into an amended Excess Risk Insurance Agreement with CHLIC. The deductible pursuant to the agreement is \$300,000 per HMO and Point-of-Service member per year and \$200,000 per Medicaid member per year. Once the deductible has been reached, CHLIC will reimburse the Corporation for eligible charges in the following manner:

- a. 90% as to each HMO and Point-of-Service plan member.
- b. 80% as to each Medicaid member.

The maximum insurance payable under this agreement for any one member is \$1,000,000. In 2007, the Corporation incurred \$4,303,600 in premiums and recovered \$1,679,305 in claims pursuant to the agreement.

### Tax Sharing Agreement

Effective with the tax year ending December 31, 2004, the Corporation entered into an Amended and Restated Tax Sharing Agreement with and among Coventry and its subsidiaries. Pursuant to the agreement, the Corporation is included in the consolidated federal income tax return filed by Coventry. The Corporation's federal income tax liability or refund is determined as if it was filing its own separate federal income tax return. If the Corporation's tax benefits (i.e. losses or credits) are used to reduce the consolidated federal tax liability, Coventry will pay the Corporation the amount equal to the reduction in the consolidated federal income tax liability. If the Corporation's tax liabilities are used to increase the consolidated federal tax liability, the Corporation will pay Coventry the amount equal to the increase in the consolidated federal income tax liability. Final settlement for a tax year shall be paid to Coventry or paid by Coventry within ninety days after the filing of the consolidated federal income tax return.

### Guarantor Agreement

Effective June 7, 2001, the Corporation entered into a Guarantor Agreement with Coventry. According to the agreement, Coventry will pay all expenses and claims incurred by the Corporation pursuant to its agreements with groups and subscribers in the event of the Corporation's inability to pay or its insolvency. Such expenses and claims shall include, but not be limited to, all hospital charges and any other fee-for-service charge for services or benefits for which the Corporation is liable, capitation payments to health care providers who have contracted with the Corporation and payments to health care providers not under contract with the Corporation for covered services rendered to a member.

### Dividends

On June 20, 2005, the Corporation filed a request with the Bureau to pay an extraordinary cash dividend of \$15,000,000 to Coventry. The Bureau approved the Corporation's request on July 13, 2005 and the dividend was paid on August 1, 2005. On March 15, 2006, the Corporation paid a cash dividend of \$15,000,000 to Coventry. On August 10, 2007, the Corporation filed a request with the Bureau to pay an extraordinary cash dividend of \$32,400,000 to Coventry. The Bureau approved the Corporation's request on September 5, 2007 and the dividend was paid on September 17, 2007.

## **TERRITORY AND PLAN OF OPERATION**

At December 31, 2007, the Corporation's service area, as reported in its 2007 Annual Statement, included the Virginia cities of Alexandria, Bedford, Buena Vista, Charlottesville, Clifton Forge, Colonial Heights, Covington, Danville, Emporia, Fairfax,

Falls Church, Fredericksburg, Galax, Harrisonburg, Hopewell, Lexington, Lynchburg, Manassas, Manassas Park, Martinsville, Norton, Petersburg, Radford, Richmond, Roanoke, Salem, Staunton, Suffolk, Waynesboro, Williamsburg and Winchester. In addition, the service area included the Virginia counties of Albemarle, Alleghany, Amelia, Amherst, Appomattox, Arlington, Augusta, Bath, Bedford, Bland, Botetourt, Brunswick, Buckingham, Campbell, Caroline, Carroll, Charles City, Charlotte, Chesterfield, Clarke, Craig, Culpeper, Cumberland, Dinwiddie, Essex, Fairfax, Fauquier, Floyd, Fluvanna, Franklin, Frederick, Giles, Goochland, Grayson, Greene, Greenville, Halifax, Hanover, Henrico, Henry, Highland, Isle of Wight, James City, King and Queen, King George, King William, Lancaster, Loudoun, Louisa, Lunenburg, Madison, Mathews, Mecklenburg, Middlesex, Montgomery, Nelson, New Kent, Northumberland, Nottoway, Orange, Page, Patrick, Pittsylvania, Powhatan, Prince Edward, Prince George, Prince William, Pulaski, Rappahannock, Richmond, Roanoke, Rockbridge, Rockingham, Russell, Shenandoah, Smyth, Spotsylvania, Stafford, Surry, Sussex, Tazewell, Warren, Washington, Westmoreland, Wise, Wythe and York. The Corporation's service area also includes the West Virginia counties of Greenbrier, Hardy, Monroe, Pendleton and Pocahontas.

Medical services are provided by physicians in independent practice within the Corporation's service area. The Corporation markets an HMO plan, an In-Network Point-of-Service (POS) plan and an Out-of-Network POS plan. Each member selects a primary care physician ("PCP") from a directory of the Corporation's primary providers. Members can go to a specialist physician without a referral, however, under the HMO and In-Network POS plans the specialist physician must be a participating provider in order for services to be covered. Members must receive prior authorization for inpatient hospital admissions and selected outpatient procedures. A member must notify the Corporation within 24 hours of an emergency room visit or emergency hospital admission.

During 2007, the Corporation had a contract with the Virginia county of Henrico comprising 17% of its total premium revenue. Additionally, the Corporation contracted with the Virginia Department of Medical Assistance Services to administer coverage to Medicaid members which comprised 13% of its total premium revenue.

### **CONFLICT OF INTEREST**

The Corporation has adopted Coventry's code of business conduct and ethics policy. The policy, as it relates to conflicts of interest, states that directors, officers, and employees should avoid situations that conflict or appear to conflict with their personal interests and the interests of the Corporation. To ensure compliance with the policy the Corporation's directors, officers and employees must complete an annual conflict of interest questionnaire that discloses any interests, affiliations, and relationships.

## **FIDELITY BOND AND OTHER INSURANCE**

At December 31, 2007, the Corporation was listed as a named insured on a financial institution bond with a \$10,000,000 limit of liability, subject to a \$500,000 deductible, to insure against losses arising from dishonest acts of its officers and employees. Additionally, the Corporation was listed as a named insured on a commercial general liability policy, a commercial umbrella liability policy, a commercial automobile policy, and a workers compensation and employers liability policy.

## **PROVIDER AGREEMENTS**

### **Medical Services**

The Corporation has entered into agreements with numerous PCPs and specialist physicians to render, provide or arrange for the provision of covered health care services to members. The Corporation compensates participating physicians on a fee-for-service arrangement. The fee-for-service arrangement is the lesser of billed charges or established fee schedules minus any applicable copayments.

### **Hospital Care**

The Corporation has entered into agreements with a number of hospitals in its service area to provide covered hospital services to members. The Corporation compensates participating hospitals on either a fee-for-service, a fixed per-diem, or a per case basis. The amounts paid to each hospital are based on terms disclosed in each individual agreement.

### **Other Health Care Services**

The Corporation has entered into various ancillary service agreements. These agreements provide mental health services, pharmacy services, laboratory services, home health care, physical therapy, durable medical equipment and other related covered health care services. Compensation is based on arrangements set forth in each contract.

## **CONTRACT FORMS**

### **Group Contracts**

The group contract agreement generally covers the following services provided by PCPs, participating specialists and other participating providers:

1. Physician Services
2. Inpatient Hospital Care
3. Preventive Care
4. Maternity Services
5. Family Planning/Infertility Services
6. Skilled Nursing Facility Confinement
7. Home Health Care Services
8. Ambulance Service
9. Emergency Services
10. Durable Medical Equipment
11. Short Term Physical, Speech and Occupational Therapy

Exclusions generally include any service, supply, or treatment not specifically covered in the Evidence of Coverage; personal comfort and convenience items; private duty nursing; cosmetic surgery; costs of services covered by a group insurance mechanism or governmental program; prescription drugs unless covered by a prescription drug rider; school physicals; physical examinations for employment or insurance; and experimental medical, surgical or mental health care procedures or services. Other exclusions include routine eye exams and visual augmentation devices; contraceptive devices; routine footcare and foot orthotics; and programs for weight reduction or smoking cessation.

The above are abbreviated descriptions of the coverages and exclusions and each individual contract may vary.

### GROWTH OF THE CORPORATION

The following data is representative of the growth of the Corporation for the ten-year period ending December 31, 2007. The data is compiled from the Corporation's filed Annual Statements, previous examination reports and the current examination report.

<u>Year</u>	<u>Total Admitted Assets</u>	<u>Total Liabilities</u>	<u>Total Capital &amp; Surplus</u>
1998	\$21,072,999	\$14,623,116	\$6,449,883
1999	22,636,724	15,426,696	7,210,028
2000	19,412,684	14,055,551	5,357,133
2001	69,138,537	48,519,126	20,619,411
2002	70,455,422	37,671,506	32,783,916
2003	76,026,998	43,578,489	32,448,509
2004	86,977,731	45,024,220	41,953,511
2005	92,640,930	46,422,914	46,218,016
2006	102,839,842	41,487,041	61,352,801
2007	106,789,201	49,564,358	57,224,843

<u>Year</u>	<u>Total Revenue</u>	<u>Net Investment Gain</u>	<u>Medical &amp; Hospital Expenses</u>	<u>Administrative Expenses</u>	<u>Pre-Tax Income (Loss)</u>
1998	\$89,221,353		\$76,019,790	\$11,977,072	\$1,224,491
1999	84,877,572		70,175,365	14,377,810	324,397
2000	99,618,257		88,289,169	15,012,974	(3,683,886)
2001 *	245,295,898	2,095,363	228,760,419	45,029,985	(26,399,143)
2002	233,641,847	1,938,671	196,378,248	32,344,819	6,857,451
2003	268,420,669	2,320,160	227,908,168	34,464,011	8,368,650
2004	310,664,732	2,499,228	256,177,136	29,962,630	27,024,194
2005	338,032,322	2,719,626	285,249,190	30,240,954	25,261,804
2006	362,886,208	3,682,867	291,610,867	29,978,418	44,979,790
2007	388,292,182	4,779,452	319,778,352	34,210,764	39,082,518

\*Prior to 2001, Net investment gains or losses were included in Total Revenue.

The Corporation's enrollment data at year-end is illustrated as follows:

<u>Year</u>	<u>Number of Members</u>
1998	46,834
1999	52,410
2000	57,728
2001	122,012
2002	97,836
2003	103,386
2004	112,040
2005	112,185
2006	106,368
2007	117,565

#### **EXCESS RISK INSURANCE**

Effective April 1, 2007, the Corporation entered into an Excess Risk Insurance Agreement with CHLIC. The specific terms of the contract are discussed in the Transactions with Affiliates section of the examination report

#### **SPECIAL RESERVES AND DEPOSITS**

At December 31, 2007, the Bureau required the Corporation to maintain a minimum deposit of \$3,380,000 with the Treasurer of Virginia.



### **SCOPE**

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2005 through December 31, 2007. Assets were verified and liabilities were established at December 31, 2007. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet for which Specific Risk Analyses (SRA) were required had medium or low risk assessments as determined from the National Association of Insurance Commissioners Examiners Handbook. Analytical review procedures were applied for non-SRA items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report.

History  
Corporate Records  
Management and Control  
Transactions with Affiliates  
Territory and Plan of Operation  
Conflict of Interest  
Provider Agreements  
Contract Forms  
Special Reserves and Deposits  
Accounts and Records  
Financial Statements

**FINANCIAL STATEMENTS**

There follows a statement of financial condition as of December 31, 2007; a statement of revenue and expenses for the year ending December 31, 2007; a reconciliation of capital and surplus for the period under review; and a statement of cash flow for the year ending December 31, 2007. The financial statements are presented in accordance with Statutory Accounting Practices.

**ASSETS**

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$79,109,538		\$79,109,538
Properties occupied by the company	2,449,728		2,449,728
Cash and short-term investments	<u>21,508,910</u>		<u>21,508,910</u>
Subtotals, cash and invested assets	\$103,068,176	\$0	\$103,068,176
Investment income due and accrued	1,152,276		1,152,276
Uncollected premiums and agents' balances in the course of collection	1,640,762	20,747	1,620,015
Amounts recoverable from reinsurers	632,347	632,347	0
Amounts receivable relating to uninsured plans	161,951		161,951
Current federal income recoverable and interest thereon	205,307		205,307
Net deferred tax asset	581,476		581,476
Furniture and equipment, including health care delivery assets	213,064	213,064	0
Health care and other amounts receivable	18,030	18,030	0
Aggregate write-in for other than invested assets	<u>348,372</u>	<u>348,372</u>	<u>0</u>
Total assets	<u>\$108,021,761</u>	<u>\$1,232,560</u>	<u>\$106,789,201</u>

**LIABILITIES, CAPITAL AND SURPLUS**

	<u>Covered</u>	<u>Uncovered</u>	<u>Total</u>
Claims unpaid	\$30,516,640	\$1,382,118	\$31,898,758
Unpaid claims adjustment expenses	654,000		654,000
Aggregate health policy reserves	206,496		206,496
Premiums received in advance		2,201,585	2,201,585
General expenses due or accrued		4,014,844	4,014,844
Current federal income tax payable and interest thereon		942	942
Amounts withheld or retained for the account of others		22,468	22,468
Remittance and items not allocated		586,369	586,369
Amounts due to parent, subsidiaries and affiliates		8,176,031	8,176,031
Liability for amounts held under uninsured plans		755,623	755,623
Aggregate write-ins for other liabilities		1,047,242	1,047,242
Total liabilities	<u>\$31,377,136</u>	<u>\$18,187,222</u>	<u>\$49,564,358</u>
Common capital stock			\$10
Gross paid in and contributed surplus			106,211,202
Unassigned funds (surplus)			<u>(48,986,369)</u>
Total capital and surplus			<u>\$57,224,843</u>
Total liabilities, capital and surplus			<u><u>\$106,789,201</u></u>

**STATEMENT OF REVENUE AND EXPENSES**

	<u>Uncovered</u>	<u>Total</u>
Net premium income	XXX	\$387,874,418
Change in unearned premium reserves and reserve for rate credits	XXX	108,314
Aggregate write-ins for other health care related revenues	XXX	10,450
Total revenues	XXX	\$387,993,182
<b>Hospital and Medical</b>		
Hospital/medical benefits	\$9,039,289	\$242,967,076
Other professional services	2,251,512	9,595,199
Emergency room and out-of-area	765,405	18,830,045
Prescription drugs		50,065,337
Subtotal	\$12,056,206	\$321,457,657
<b>Less:</b>		
Net reinsurance recoveries		1,679,305
Total hospital and medical	\$12,056,206	\$319,778,352
Claims adjustment expenses	11,431,025	11,431,025
General administrative expenses	22,651,863	22,651,863
Total underwriting deductions	\$46,139,094	\$353,861,240
Net underwriting gain	XXX	\$34,131,942
Net investment income earned		\$4,776,761
Net realized capital gains		2,691
Net investment gains		\$4,779,452
Net (loss) from agents' or premium balances charged off		(\$127,876)
Aggregate write-ins for other income	\$299,000	\$299,000
Net income before federal income taxes	XXX	\$39,082,518
Federal income taxes incurred	XXX	11,377,279
Net income	XXX	\$27,705,239

**RECONCILIATION OF CAPITAL AND SURPLUS**

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Capital and surplus prior reporting year	<u>\$41,953,511</u>	<u>\$46,218,016</u>	<u>\$61,352,801</u>
<b>GAINS AND LOSSES TO CAPITAL AND SURPLUS</b>			
Net income	\$19,170,352	\$31,420,036	\$27,705,239
Change in net deferred income tax	(250,398)	61,815	(3,223,557)
Change in nonadmitted assets	344,551	(1,347,066)	3,790,360
Dividends to stockholders	<u>(15,000,000)</u>	<u>(15,000,000)</u>	<u>(32,400,000)</u>
Net change in capital and surplus	<u>\$4,264,505</u>	<u>\$15,134,785</u>	<u>(\$4,127,958)</u>
Capital and surplus end of reporting year	<u><u>\$46,218,016</u></u>	<u><u>\$61,352,801</u></u>	<u><u>\$57,224,843</u></u>

**CASH FLOW****Cash from Operations**

Premiums collected net of reinsurance	\$388,173,727
Net investment income	5,348,643
Miscellaneous income	10,450
Total	<u>\$393,532,820</u>
Benefit and loss related payments	\$315,002,156
Commissions, expenses paid and aggregate write-ins for deductions	31,590,707
Federal income taxes paid	13,117,762
Total	<u>\$359,710,625</u>
Net cash from operations	<u>\$33,822,195</u>

**Cash from Investments**

Proceeds from investments sold, matured or repaid:	
Bonds	\$13,247,332
Net gains or (losses) on cash and short-term investments	624,064
Miscellaneous proceeds	257
Total investment proceeds	<u>\$13,871,653</u>
Cost of investments acquired (long-term only):	
Bonds	\$24,522,019
Miscellaneous applications	799,051
Total investments acquired	<u>\$25,321,070</u>
Net cash from investments	<u>(\$11,449,417)</u>

**Cash from Financing and Miscellaneous Sources**

Cash provided (applied):	
Dividends to stockholders	(\$32,400,000)
Other cash provided	4,189,514
Net cash from financing and miscellaneous sources	<u>(\$28,210,486)</u>

**RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS**

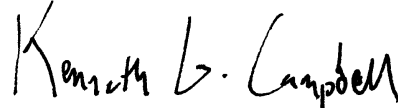
Net change in cash and short-term investments	(\$5,837,708)
Cash and short-term investments:	
Beginning of the year	<u>27,346,618</u>
End of the year	<u>\$21,508,910</u>

**CONCLUSION**

The courteous cooperation extended by the Corporation's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Darrin Bailey, CFE, Cliff Lewis, CFE, and George Morgan, CFE, participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink that reads "Kenneth G. Campbell". The signature is written in a cursive style with a large, stylized 'K' and 'C'.

Kenneth G. Campbell, CFE  
Assistant Chief Examiner





STATE COMMISSION  
BUREAU OF INSURANCE  
08 NOV 10 AM 9:35

November 6, 2008

Mr. David H. Smith, CFE, CPA, CPCU  
Chief Examiner  
State Corporation Commission  
Bureau of Insurance  
Post Office Box 1157  
Richmond, Virginia 23218

**RE: Southern Health Services, Inc.  
Examination Report as of December 31, 2007**

Dear Mr. Smith:

Please consider this letter to be written acknowledgement of the receipt of the above-captioned examination report that was sent to Southern Health Services, Inc. on November 3, 2008. We understand that this report will be filed as a public document ten days after the thirty days allowed for the receipt of written submissions.

In response to your question concerning the number of copies of the report we would need, we respectfully request twelve (12) copies of the final report.

We look forward to receiving the final examination report and appreciate the professional manner in which your staff performed their review.

Sincerely,

A handwritten signature in black ink that reads "Cosby M. Davis, III". The signature is fluid and cursive, with the last name "Davis" being the most prominent part.

Cosby M. Davis, III  
President and Chief Executive Officer

Coventry Health Care is a registered trade name of Carelink Health Plans, Inc., a West Virginia HMO, and Southern Health Services, Inc., a Virginia HMO. PPO products are underwritten by Coventry Health and Life Insurance Company and administered by Carelink Health Plans, Inc. in West Virginia and Southern Health Services, Inc. in Virginia.

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